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October 23, 2002

BY ELECTRONIC FILING

Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: *Written Ex Parte*
UNE Triennial Review – CC Docket No. 01-338
Local Competition – CC Docket No. 96-98
Deployment of Advanced Wireline Services – CC Docket No. 98-147

Dear Ms. Dortch:

Attached for inclusion in the record of the three above-referenced proceedings is a legal memorandum, entitled "Legal Issues Presented in the UNE Triennial Review," filed on behalf of WorldCom, Inc.

Sincerely,

/s/Ruth Milkman
Ruth Milkman

Attachment

cc: Christopher Libertelli
Jordan Goldstein
William F. Maher
Michelle Carey
Jeremy Miller
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WORLDCOM[SM]

Legal Issues Presented in the UNE Triennial Review

No single issue is likely to be of greater significance to the survival of competition for local telecommunications services than the issue of what standard the Commission will adopt to implement the requirements of section 251(d)(2) of the Communications Act of 1934, as amended ("the Act").[1] Simply stated, the Commission must adopt a standard that is consistent with both the guidance provided by federal appellate courts that have reviewed that statutory provision[2] as well as Congress' mandated goals of promoting local competition and deregulation.

WorldCom, Inc. ("WorldCom") and other competitive local exchange carriers ("LECs") presented their analysis of the appropriate standard for applying section 251(d)(2)'s "impairment" test in their initial comments in this proceeding. On reply, WorldCom and others showed that the standard the Commission previously has used in applying that section could be applied in a manner that is consistent both with the D.C. Circuit's intervening decision in *USTA v. FCC*[3] and the Commission's commitment to realizing the procompetitive goals of the Act. The Bell Operating Companies ("BOCs"), however, urged the Commission to interpret *USTA* in a manner that would cause unnecessary harm to new entrants and frustrate the Commission's attempts to open the local telecommunications business to meaningful competition.[4]

This written *ex parte* is intended to assist the Commission in reaching a reasoned decision on this critical issue. Specifically, WorldCom below identifies points of agreement with the BOCs' interpretation of section 251(d)(2) and also addresses erroneous and misleading arguments advanced by the BOCs.

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1 47 U.S.C. § 251(d)(2).

2 *See, e.g.*, *Verizon Communications Inc. v. FCC*, – U.S. –, 122 S. Ct. 1646 (2002) ("*Verizon*"); *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 119 S. Ct. 721 (1999) ("*Iowa Utilities Board*"); *United States Telecom Ass'n v. FCC*, 290 F.3d 415 (D.C. Cir. 2002) ("*USTA*").

3 *USTA*, 290 F.3d 415.

4 Unlike the positions advanced by WorldCom and other competitive carriers, the BOCs' arguments are often at odds with the U.S. Supreme Court's recent decision in *Verizon*.

I. THE DIFFERENCE BETWEEN INCUMBENTS' AND COMPETITORS' COSTS IS KEY TO DETERMINING IMPAIRMENT IN ACCORDANCE WITH THE HOLDING IN *USTA*

In its reply comments, WorldCom explained that, under the guidance provided by the court in the *USTA* decision, costs remain highly relevant to the impairment analysis, particularly since the cost disadvantages faced by new entrants into the local telecommunications business are not universal to new entrants in all industries,[5] and are not offset by the advantages new entrants may have as they try to establish a foothold in the local telecommunications business.[6]

A. Dr. Shelanski's Analysis Omits Key Factors that Differentiate the Local Telecommunications Business from Other High-Fixed-Cost Businesses

In a declaration attached to Verizon's reply comments, Dr. Howard Shelanski argues that in many high-fixed-cost industries – including the DBS, PCS, and airline industries – "competitors build facilities and prepare to compete with established firms well before they have any assurance of attracting a single customer."[7] While this statement may be correct, it is not the end of the analysis required under section 251(d)(2), because it does not include a discussion of either the magnitude of the economies of scale or the role of sunk costs in the local telecommunications industry.

One significant difference between the local telecommunications business and other industries discussed by Dr. Shelanski is the magnitude of the economies of scale that exist in the local telecommunications infrastructure.[8] For instance, whereas DBS companies have been able to enter and remain in business with less than ten percent of U.S. households as customers, no competitive LEC could build its own loop plant and achieve an acceptable level of efficiency with such a small share, unless other carriers also were able to achieve sufficient shares to erase the incumbents' overall advantage.[9]

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5 WorldCom Reply Comments at 13-18. (Unless otherwise indicated, all Comments, Reply Comments and *ex parte* presentations cited herein were filed in *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338.)

6 *Id.* at 18-19.

7 Reply Declaration of Howard A. Shelanski ¶ 4 (Attachment A to Verizon Reply Comments) ("Shelanski Declaration").

8 *See, e.g.*, Reply Declaration of Mark Bryant ¶ 9 (Attachment A to WorldCom Reply Comments) ("Bryant Declaration").

9 While the incumbents' advantages diminish as competitors' share increases, the specific cross-over point at which competitors' cost disadvantages can be overcome without unbundled network elements ("UNEs") differs by network element. Additionally, the incumbents' cost advantages are affected by the aggregate share of all competitors in the relevant market. While one competitor with 10% share may face a significant disadvantage relative to an incumbent LEC with 90% share, that same

Of course, consumers would not benefit from a regime in which no competitor is able to benefit from the scale economies present in the incumbent LECs' loop plant.

A second significant difference is the presence of high sunk costs in the telecommunications industry. Because airlines incur considerably smaller sunk costs than local telecommunications firms, Dr. Shelanski's reliance on the pattern of entry in the airline industry is largely irrelevant to the discussion of impairment under the Act.[10] Unlike competitive LECs, new entrants into the airline industry exercise a constraining effect over the incumbent airline firms, even in markets (such as thin routes) where economies of scale are a major factor. This effect results in part from the fact that an airplane can be redeployed to wherever demand is greatest: if there is reduced demand on the New York to Los Angeles route, an airline can simply shuffle its fleet to another route where demand is greater.

In contrast, a telecommunications company cannot easily redeploy or reroute outside plant from one location to another. If a customer served over a competitor's local loop decides to switch back to the incumbent, then the competitor's investment in the loop will be stranded.[11] Investments in loop plant, transport, collocation arrangements and other facilities, unlike investments in airplanes, are largely sunk costs that cannot be moved or reused to serve different customers or different locations. Accordingly, Dr. Shelanski's examples demonstrate only that competitors have been able to enter industries that have high fixed costs but lack the high sunk costs that characterize the local telecommunications business.

The Declaration of Dr. Joseph Farrell, which Qwest filed with its reply comments, is fundamentally consistent with WorldCom's views regarding the base economic analysis the Commission should apply in this proceeding. Dr. Farrell states that "the right enquiry is not simply about the presence or even (within ordinary limits) the degree of economies of scale, but concerns more broadly whether unbundling substantially strengthens the threat of entry in ensuring that incumbents must hew reasonably close to competitive performance in each network element."[12] Dr. Farrell agrees with

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competitor would be in a far better position if two other competitive carriers were also able to capture 10% shares, leaving the incumbent with 70%. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* Declaration of Mark T. Bryant, ¶ 30, attached to Comments of MCI WorldCom, Inc., CC Docket No. 96-98 (May 26, 1999).

10 WorldCom Reply Comments at 16-17.

11 As WorldCom noted in its reply comments, in this regard UNEs serve the incumbents well, allowing them to generate a return on their investment even if a customer served over the incumbent's facilities switches to another carrier. When WorldCom uses UNE-P to serve a local customer it has won from Verizon, it compensates Verizon at TELRIC-based rates for the use of its facilities, ensuring that Verizon continues to recover its costs for those facilities. *See id.* at 17, n.39.

12 Declaration of Joseph Farrell ¶ 12, Attachment A to Qwest Reply Comments ("Farrell Declaration").

WorldCom's central point that relatively high sunk costs – such as those that characterize the local telecommunications industry – can justify imposing unbundling requirements on the incumbent LEC.[13]

B. The Ability to Achieve Economies of Scale in the Future Does Not Overcome the Existence of Impairment Today

Qwest argues that competitive LECs should be denied UNEs now if it is possible that they could achieve the necessary economies of scale at some time in the future.[14] This argument is based on a misreading of the *USTA* decision. Although the *USTA* court noted that average unit costs are higher at the outset for new entrants into almost any new business, it did not foreclose the possibility that new entrants in the local telecommunications business may face cost disparities that are different from those faced by new entrants in any industry and that these cost disparities may constitute impairment.[15] The loop plant, for example, has natural monopoly characteristics such that no competitor ever could match the incumbent's scale economies, short of displacing the monopolist. Indeed, as WorldCom has demonstrated, the high proportion of fixed costs that characterize the local telephone business presents cost disadvantages that exceed those of new entrants in most other industries.[16] These disadvantages constitute impairment and justify unbundling under the principles set forth in the *USTA* decision.

C. TELRIC-based Rates Provide a Valid Point of Comparison for Evaluating Competitors' Cost Disadvantages

Verizon contends that "the Commission cannot find impairment based on a comparison of the cost of the alternative arrangements and the cost of UNEs. By their very nature, TELRIC-based rates almost always will render UNEs less expensive than building out alternative facilities."[17] A comparison of the costs of incumbents and new entrants, including their relative abilities to take advantage of economies of scale, has always been central to the impairment analysis,[18] and the *USTA* decision affirms the significance of costs.[19] Cost comparisons require a common method of assessing costs. Use of TELRIC models allows a comparison of the forward-looking costs of the

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13 *See* WorldCom Reply Comments at 14-18; Farrell Declaration ¶ 13.

14 Qwest Reply Comments at 9 (*citing USTA,* 290 F.3d at 426-427).

15 *See USTA*, 290 F.3d at 427.

16 *See* WorldCom Reply Comments at 14-16; Bryant Declaration ¶ 8.

17 Verizon Reply Comments at 40-41.

18 *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, ¶ 285 (1996) ("*Local Competition Order*"); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, ¶¶ 72-88 (1999) ("*UNE Remand Order*").

19 *USTA*, 290 F.3d at 426-428.

incumbent LECs to serve the entire market with the forward-looking costs of the competitive LEC at different levels of market penetration. The competitive LEC can compete with the incumbent LEC using its own facilities only if it can achieve sufficient market penetration that its forward-looking costs are roughly the same as the incumbent LEC costs after taking into account any cost advantages that it may have. The greater the level of market penetration required to achieve such cost parity, and the greater the differential in costs at levels below this level of penetration, the greater the impairment. Of course, the magnitude of the cost differential is not the only factor relevant to an assessment of impairment. The degree to which the costs incurred will be sunk costs, as well as other factors, are also relevant. Thus, Verizon's concern that impairment will be found whenever TELRIC-based rates prove lower than the cost of building out alternative facilities is misplaced. A material difference in costs is a significant, but not the sole, criterion for determining impairment.

For example, in theory the incumbent LECs' cost advantages may be offset by some advantage that competitors enjoy.[20] Any advantages that competitive LECs may enjoy today, however, relative to incumbent LECs (*e.g.*, lower labor costs or superior back office systems),[21] pale in comparison to the enormous advantages the incumbent LECs have accrued through their years of market dominance.[22] The incumbent LECs have vast networks already in place capable of reaching all customers in their serving areas. The overwhelming majority of new construction undertaken by the incumbent LECs is merely incremental investment designed to expand the reach of their already nearly ubiquitous networks. Competitive LECs, on the other hand, must incur large fixed and sunk costs to deploy new facilities to reach customers as they build a customer base from scratch.

D. True "Green Field" Investment By the BOCs is Rare

SBC argues that whatever cost advantages the incumbent LEC may have with respect to existing facilities, those cost advantages cannot exist with respect to incumbent LEC facilities that are constructed to serve new or "green field" locations, and therefore, that these facilities should be exempt from any unbundling requirements.[23] Real "green field" investment is extremely rare, however.[24] Indeed, SBC itself recognizes that true "green field" investment exists only when an incumbent LEC and competitive carriers share the same advantages and disadvantages with respect to bringing new service to a particular location.[25] Using SBC's definition, unserved locations that are near an

20 *See id.* at 423.

21 *See, e.g.*, Verizon Reply Comments at 94. BellSouth's arguments regarding retail rate differences are already addressed in WorldCom's reply comments. WorldCom Reply Comments at 25-27 (explaining that retail rates are irrelevant to the impairment analysis).

22 WorldCom Reply Comments at 19.

23 SBC Reply Comments at 12, 54, 57-58.

24 WorldCom Reply Comments at 49.

25 *See* SBC Reply Comments at 56-57.

incumbent LEC's existing customers cannot properly be considered "green field" locations, since the incumbent LEC's ability to extend lines from its existing plant allows it to take advantage of economies of scale that are unavailable to competitive carriers. Thus, despite the BOCs' attempts to overextend the "green field" metaphor, the fact remains that that incumbent LECs retain significant economic advantages in serving the vast majority of new residential or commercial areas.

II. GEOGRAPHIC GRANULARITY AFTER THE *USTA* DECISION

WorldCom and the BOCs agree that, particularly in light of the *USTA* decision, a geographically granular impairment analysis is appropriate, at least for some elements. Moreover, like WorldCom, individual BOCs have come to the view that transport must be evaluated on a central office-by-central office basis. As explained below, however, WorldCom disagrees with the BOCs regarding the role that states should play in determining impairment.

A. The MSA Does Not Always Provide the Proper Level of Geographic Granularity

WorldCom recognizes that some elements should be subject to a geographically granular impairment analysis, but it disagrees with BellSouth's contention that the MSA is necessarily the relevant geographic market for those elements.[26] The MSA does not provide the appropriate level of granularity for many elements. As BellSouth apparently has come to recognize, impairment for dedicated interoffice transport, for instance, must be analyzed on a central office-by-central office basis.[27] After all, the presence of a competitive provider in one wire center is of no use to a competitive carrier seeking to serve customers served out of a different wire center.[28] A more generalized MSA-wide approach would ignore key variations within the MSA that could effectively thwart competitors' ability to reach many potential customers.

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[26] BellSouth Reply Comments at 11-12.

[27] *See* BellSouth's *ex parte* presentation, attached to letter to Marlene Dortch, FCC, from William W. Jordan, BellSouth, at 3 (Aug. 26, 2002) (proposing that dedicated transport be analyzed based on the number of competitive transport providers present in a particular wire center); *see also* WorldCom Reply Comments at 126; SBC Comments at 88 (recognizing that impairment for interoffice transport should be evaluated on a wire center-by-wire center basis).

[28] Indeed, in certain circumstances, the presence of multiple competitive providers in a single wire center does not ensure that requesting carriers will not be impaired without unbundled access to incumbent LEC interoffice transmission facilities. For example, where the incumbent carrier imposes unreasonable limits on circuit migration (a.k.a. "grooming") orders, the Commission should still find that impairment exists. *See* Letter to Marlene H. Dortch, FCC, from Henry G. Hultquist, WorldCom, at 1 & Attachment at 6-8 (Oct. 1. 2002) ("*October 1 Ex Parte*").

B. Role of the States

Under the proposal described in WorldCom's reply comments, the FCC would make determinations regarding certain UNEs (*e.g.*, loops or OSS) on a national basis. For UNEs (*e.g.*, transport) for which a geographically granular analysis is appropriate, the FCC would provide a list of factors for states to consider in evaluating impairment, but the states would be the arbiters of whether unbundling should be required. Until a state commission finds that competitive LECs are not impaired, these UNEs would be available to competitive LECs. This approach is clearly permissible; Qwest acknowledges that states have the authority to make factual determinations pursuant to guidelines devised by the FCC.[29] The greater state role that WorldCom proposes is the most sensible way to respond to the *USTA* court's suggestion that greater granularity is needed in making unbundling decisions.

In addition, states should remain free to require incumbent LECs to provide UNEs beyond those mandated under the FCC's rules. Allowing states to impose their own UNE requirements is sound both as a matter of law and as a matter of policy. Contrary to the BOCs' assertions,[30] states are not preempted from imposing additional unbundling obligations.[31] In fact, Congress clearly expected that states would continue to have a role to play, as demonstrated by the Act's explicit mandate that "the Commission shall not preclude the enforcement of any [state] regulation" that is consistent with statutory requirements unless it "*substantially* prevent[s] implementation of the requirements of this section and the purposes of this part."[32] This section was clearly intended to establish significant leeway for state action beyond that taken by the Commission. It is thus impossible to conclude, as the BOCs suggest, that any state unbundling requirement that goes beyond that required by the Commission would inherently be inconsistent with the statutory purposes – much less substantially inconsistent with those purposes. Moreover, as the BOCs have noted in the past, even if the FCC has the ability to preempt state commissions' authority to require UNEs, it certainly is not required to do so and it should not do so.[33] Consistent with the Act, state commissions should continue to have

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29 Qwest Reply Comments at 28, n. 92; WorldCom Reply Comments at 23-24.

30 *See, e.g.*, BellSouth Reply Comments at 71-72.

31 *See* 47 U.S.C. § 261(c); *see also Commission Investigation and Generic Proceeding of Ameritech Indiana's Rates for Interconnection, Service, Unbundled Elements, and Transport and Termination Under the Telecommunications Act of 1996 and Related Indiana Statutes*, Order, Cause No. 40611-S1, Phase II (Indiana Util. Reg. Commission, June 2002) (rejecting argument that the Court of Appeals' decision in *USTA* diminishes states' authority to impose unbundling requirements in addition to those imposed by the FCC).

32 47 U.S.C. § 251(d)(3) (emphasis added); *see also* 47 U.S.C. § 261(c).

33 *See* Comments of Pacific Telesis, *Local Competition* Docket No. 96-98, Summary at 4 (May 16, 1996) ("Section 251 regulations should not, and cannot be used implicitly to preempt State regulation of the terms and conditions of State services."); Bell Atlantic Comments, *Local Competition* Docket No. 96-98, at 2 (May 16, 1996) (stating that "access to elements of the LECs' uniquely intrastate networks" is a "fundamentally

the freedom to impose additional unbundling requirements if they find that additional UNEs would help promote competition in areas under their jurisdiction.[34]

C. The BOCs' Application of the Impairment Standard is Inconsistent with *USTA*'s Requirement of a Granular Analysis

It bears noting that, in their reply comments, the BOCs do not engage in the kind of geographically granular impairment analyses that *USTA* demands. Although they occasionally pay lip service to granularity, in reality the BOCs rely on non-granular data (*e.g.*, region-wide statistics) to argue that particular network elements should not be unbundled on a national (or at least regional) scale. For instance, although BellSouth claims that the appropriate geographic market for assessing impairment is the MSA, it then argues that competitive LECs are not impaired without access to loops, inter-office transport and switching based on aggregated MSA, regional or nationwide data.[35] Similarly, SBC argues for a granular analysis, but then offers nationwide data to support its claim that competitive LECs are not impaired without access to high-capacity business loops and dark fiber.[36] Such aggregate MSA, region-wide or national statistics are insufficient to show a lack of impairment based on *USTA* and should be rejected.

III. UNBUNDLING OBLIGATIONS SHOULD NOT BE LIFTED PREMATURELY

A. One Competitor Is Not Enough

Qwest asks the Commission to find that there can be no impairment in any area where a competitive carrier does, or could, offer service over non-ILEC facilities.[37] This overly simplistic standard ignores the wide variety of obstacles facing new entrants into

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intrastate" matter); *see also* GTE Comments, *Local Competition* Docket No. 96-98, at 10 (May 16, 1996) ("The states as a whole are committed to competition, as is the FCC. Moreover, they are far closer to the needs of consumers, and indisputably are better equipped to assure that the transition to local competition occurs in a rational manner ... Deference to the states is particularly warranted because PUCs generally develop rules using procedures that allow for comprehensive fact-finding based upon local conditions.").

34 Such a result clearly is permissible under the Act. *See, e.g., Iowa Utilities Board*, 525 U.S. at 388 (upholding states' right to make additional elements available on a case-by-case basis). While states are preempted from removing unbundling obligations imposed by the FCC, they remain free to add additional obligations necessary to promote intrastate competition. *See* 47 U.S.C. §§ 251(d)(3), 261(c).

35 *See* BellSouth Reply Comments at 11-15 (citing regional MSA figures and arguing for an MSA-level analysis), 37-38 (citing regional and aggregate MSA data), 23 (citing nationwide switching data).

36 *See* SBC Reply Comments at 154-156.

37 Qwest Reply Comments at 16-17.

the local telecommunications business. Actual or potential deployment by one carrier is not enough to justify relieving an incumbent LEC of its unbundling obligations.

There are two ways in which deployment by a competitive carrier could be relevant to the impairment. It could: (1) provide a competitive source of supply for network elements; or (2) serve as evidence that barriers to entry have been reduced. In either case, the fact that one new entrant offers service over non-incumbent LEC facilities – or speculation that a new entrant could offer service in such a manner – would not, in and of itself, justify relieving an incumbent LEC of its unbundling obligations.

For the Commission to achieve Congress' goal of introducing meaningful competition into the local telecommunications business, multiple new entrants must be in a position to viably compete against the incumbent LECs. One competitor simply is not enough.[38] BellSouth attempts to undermine this principle by questioning the relevance of one of Allegiance's sources for its proposal that four non-incumbent LEC sources of supply should exist before unbundling relief is granted.[39] Regardless of the limitations of the particular game theory model relied upon by Allegiance, it is clear that the availability of service from "several different providers" is a "basic indicator of meaningful economic competition."[40] WorldCom in particular has shown that a

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[38] In their section 271 advocacy, the incumbent LECs have steadfastly claimed that their ability to offer interLATA services would benefit competition because three competitors is not sufficient. *See, e.g.*, MacAvoy Declaration 19-23, 66, *Application by New York Telephone Company for Authorization to Provide In-Region InterLATA Service*, Docket No. 99-295 (explaining that "[i]t is axiomatic that one to three suppliers in a market seek prices at the highest non-competitive level" and relying on the HHI index used in the DOJ Merger Guidelines to calculate concentration in the long distance market). *See also Application of EchoStar Communications Corp., General Motors Corp., and Hughes Electronics Corp. (Transferors), and EchoStar Communications Corp. (Transferee),* CS Docket No. 01-348, Hearing Designation Order ¶¶ 275-76 (rel. Oct. 18, 2002) (FCC 02-284) ("it is well recognized that competition . . . has the greatest potential to bring consumer welfare gains"); *id.* ¶ 280 (loss of competition by reducing number of viable service providers from three to two or two to one is likely to result in significant harm to consumers, "creating the potential for higher prices and lower service quality, and negative impacts on future innovation").

[39] *See* Reply Declaration by National Economic Research Associates, Inc., Attachment 1 to BellSouth Reply Comments, ¶ 128 ("NERA Report") (criticizing R. Selten, "A Simple Model of Imperfect Competition, Where 4 are Few and 6 are Many," *International Journal of Game Theory*, 2(2), 1973, at 141-201).

[40] *2000 Biennial Regulatory Review, Spectrum Aggregation Limits for Commercial Mobile Radio Services,* Report and Order, 16 FCC Rcd 22668 ¶ 31 (2001) (noting in support of a finding of meaningful competition that 75% of the U.S. population lived in a county where five or more providers offered service and that over 133 million people lived in counties with six or more mobile telephony providers); *see also Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,* Seventh Report, 17 FCC Rcd 12985, 12989 (2002) (noting that 80% of the U.S. population lives in counties with five or more competing mobile telephone operators as support for a finding of strong competitive development).

minimum of four non-affiliated providers must be present in a given geographic market before the Commission can realistically expect the marketplace to generate a sufficient source of non-incumbent LEC supply to alleviate the need for regulated unbundling.[41] With fewer than four providers, it is unlikely that there will be sufficient competition to eliminate impairment if requesting carriers were denied access to incumbent LEC UNEs.[42]

Similarly, the existence of a single new entrant – or potential new entrant – in a geographic market does not prove that the barriers to entry in that market have been eliminated or that multiple competitive carriers can enter the same market.[43] Indeed, if the Commission eliminates an incumbent LEC's unbundling obligations based on the existence of one new entrant, it runs the risk of creating a duopoly. While duopolies may be preferable to monopolies, they fall far short of creating the type of robust competition Congress envisioned in passing the Act.[44] The only way to achieve the level of competition necessary to satisfy the Act and relieve the incumbent LECs of their unbundling obligations is to carefully examine entry conditions.

Qwest's attempt to use cable rules to support its argument that a single competitor is enough to justify a finding of "effective competition" is inapposite.[45] As Qwest acknowledges, the statute it cites applies to cable providers, not telecommunications carriers.[46] It is clear that cable and wireline service were intentionally subjected to different regulations. In passing the 1996 Act, Congress specifically chose to subject telecommunications carriers, but not companies to the extent they are carrying video programming, to the unbundling rules. The Commission may not override this decision by Congress. In any event, no competitive carrier currently has a 15% share of the local

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41 *See, e.g.*, WorldCom Reply Comments at 126-127 (explaining the need to have at least four non-affiliated competitors offering transport out of a particular wire center as a precondition to relieving an incumbent LEC of the obligation to provide unbundled transport out of that wire center).

42 *See generally* HAI Report at 82-84; WorldCom Reply Comments at 127.

43 *See* WorldCom Reply Comments at 29.

44 *See, e.g.*, WorldCom Reply Comments at 82-83 (explaining why duopolies do not create sufficient competition); *see also* Statement of Chairman Michael K. Powell, CS Docket No. 01-348, at 1 (rel. Oct. 10, 2002) ("At best, th[e] [EchoStar/DirecTV] merger would create a duopoly in areas served by cable; at worst it would create a merger to monopoly in unserved areas. Either result would decrease incentives to reduce prices, increase the risk of collusion, and inevitably result in less innovation and fewer benefits to consumers. That is the antithesis of what the public interest demands.").

45 Qwest Reply Comments at 17-18 & n.60 (*citing* 47 U.S.C. § 543(l)(1)(B)(ii) ("effective competition" exists where market share of competitive multichannel video programming distributor exceeds 15%)).

46 *See id.*

telecommunications business.[47] Thus, even if the cable statute were improperly imported into the telecommunications arena as Qwest suggests, it would not result in a finding of "effective competition" or prevent a finding of impairment.

B. Far From Alleviating the Need for Unbundling, Unused Competitive Capacity May In Fact Demonstrate Impairment

Qwest argues that the existence of unused competitive LEC capacity shows that competitors can serve new customers without relying on incumbent LEC facilities.[48] As WorldCom explained in its reply comments, excess competitive LEC capacity may alleviate impairment if there are enough competitors serving the market in question. For example, the existence of four or more competitors offering service to other carriers in a particular wire center may be an indication that sufficient competitive transport is available to justify relieving the incumbent of its obligation to provide unbundled transport from that wire center. Excess capacity alone is not enough, however. Before an incumbent can be relieved of its obligation to provide unbundled dedicated transport out of a particular wire center, it must also (1) provide assurances that end users will be able to receive uninterrupted service even if their service provider switches to non-incumbent LEC provided transport; and (2) commit to cooperate fully in completing circuit migrations in a timely manner.[49]

Similarly, the existence of excess switching capacity alone is not sufficient to demonstrate that competitive LECs are not impaired in their ability to offer service. As WorldCom has demonstrated, even if sufficient switching capacity existed (which may not be the case in many smaller markets), problems with hot cuts, the costs of collocation and the costs of transport would still need to be addressed before an incumbent LEC could be relieved of its obligation to provide unbundled switching.[50] The incumbent LECs argue that competitive carriers possess, but are not using, excess switching capacity. But this is powerful evidence that transactional difficulties are making it impossible to use that switching capacity. After all, the marginal costs to the competitive LEC of using excess capacity on its own switch and over its own transport facilities will be very small – certainly far lower than the TELRIC rate for unbundled switching or transport. Nonetheless, because of the costs and provisioning difficulties in the hot cut process, as well as the cost of installing analog equipment in the collocation cage (and, in some instances, in renting additional collocation space), WorldCom is not able to serve mass market customers using its own switches. The fact that WorldCom (and other

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47 *See* "Local Telephone Competition: Status as of December 31, 2001," Industry Analysis and Technology Division, Wireline Competition Bureau, Table 1 (July 2002), *available at*: <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0702.pdf>.

48 Qwest Reply Comments at 8; Farrell Declaration ¶ 17.

49 *See* WorldCom Reply Comments at 126-129; *October 1 Ex Parte* at 1-2 & Attachment at 6-8.

50 WorldCom Reply Comments at 138-149.

competitive LECs) are unable to use switch capacity that is essentially free to serve mass market customers, strongly suggests that the barriers to doing so are formidable and that competitive LECs are impaired without access to unbundled switching.

C. The Commission Should Be Guided by Evidence, Not Inference

SBC contends that the Commission should look at facilities competitive LECs have deployed in certain geographic markets and draw inferences regarding the feasibility of competitive deployment in other geographic markets.[51] However, as SBC itself points out, "the Commission must be guided by actual marketplace evidence, which is far more probative than theoretical concerns."[52] Thus, by SBC's own admission, the best indication of whether competitive LECs can deploy their own facilities is whether they have in fact deployed facilities that are being used to serve a particular market. This is especially true because, as WorldCom has explained, given the choice, competitive carriers would prefer not to depend on incumbent LEC facilities unless it is absolutely necessary to do so.[53] Wherever feasible, competitive LECs can therefore be expected to deploy their own facilities or purchase from non-ILEC sources. There is therefore no need for the FCC to substitute conjecture for the realities of the market.

On a related note, BellSouth would have the Commission require competitive LECs seeking access to UNEs to demonstrate that they are reasonably efficient and cannot obtain the needed elements from non-incumbent LEC sources.[54] In no event should competitive LECs be required to carry the burden of showing they are impaired, as BellSouth suggests. In general, the incumbent LECs are in the best position to provide evidence of competitive entry (*e.g.*, the number of fiber-based carriers offering transport out of a particular wire center).[55] The Commission should thus require incumbent LECs to provide the data necessary to allow either the FCC or a state commission to conduct its impairment analysis.

D. The "At A Minimum" Language Should Not Be Used To Limit Unbundling Where Impairment Is Found to Exist

According to the BOCs, the "at a minimum" language of section 251(d)(2) permits the FCC to determine that a network element should not be unbundled even if

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[51] SBC Reply Comments at 13.

[52] *Id.* at 67.

[53] *See, e.g.*, WorldCom Comments at 82-83. As long as UNE prices are set at TELRIC, competitive LECs will have the proper incentives.

[54] BellSouth Reply Comments at 12-13; NERA Report ¶ 135.

[55] *See, e.g.*, *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶ 172 (1999) (requiring incumbent LECs to carry the burden of producing evidence that competitors actually offer service over their own facilities because "an incumbent LEC is in the best position to present evidence of the extent of collocation in its wire centers within an MSA").

competitors would be impaired without unbundled access to that element.[56] The "at a minimum" language should not be used as an excuse to relegate the "impair" standard to secondary status in determining whether to require unbundling. As the D.C. Circuit stated in *USTA*, "Congress . . . made 'impairment' the touchstone" of the unbundling analysis.[57] The Commission therefore should make clear that it will continue to view the "impair" standard as being of paramount importance in determining whether to require unbundling, and should refrain from using the "at a minimum" language to relieve an incumbent LEC of its obligation to unbundle an element in the face of a finding that requesting carriers are impaired without access to that element.

E. Adopting an "Essential Facilities" Test for Impairment Would Be Inconsistent With the Act

In *USTA*, the Court of Appeals expressly declined to adopt the BOCs' argument that the Commission must incorporate the antitrust "essential facilities" doctrine into its impairment analysis.[58] As Z-Tel explained in its Reply Comments, the court's decision was clearly correct.[59] Importing the essential facilities doctrine into the impairment analysis would be inconsistent with the goals, the plain language, and the legislative history of the 1996 Act.

Developed under section 2 of the Sherman Act, the essential facilities doctrine is targeted at preventing the perpetuation or extension of monopoly power though wrongful or predatory acts where the monopolist has exclusive or near-exclusive control over inputs that are "essential" for the existence of competition.[60] In comparison, the 1996 Act is intended affirmatively to foster competition and eliminate monopoly power that was originally lawfully-obtained by incumbent LECs. Indeed, as the Supreme Court has recognized, the 1996 Act is designed "to reorganize markets" by "uprooting the [local telephone] monopolies that traditional [regulation] had perpetuated."[61] The goal of the essential facilities doctrine is thus quite different from the ultimate goal of the Act. Accordingly, it makes no sense to limit the scope of the Act's market-opening provisions by tying them to the essential facilities doctrine.

Adopting the essential facilities test for impairment would also be inconsistent with the text of the 1996 Act. The ordinary meaning of the term "impair" is "to weaken,

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56 *See* Qwest Reply Comments at 18; SBC Reply Comments at 50-51; Verizon Reply Comments at 47-50.

57 *USTA*, 290 F.3d at 425.

58 *Id.* at 427.

59 Z-Tel Reply Comments at 56-62; *see also* WorldCom Reply Comments at 19-20.

60 *See United States v. Grinnell Corp*, 384 U.S. 563, 570-71 (1966); *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1132-33 (7th Cir. 1983).

61 *Verizon*, 122 S. Ct. at 1660-61.

to make worse, to lessen in power, diminish, or relax, or otherwise affect in an injurious manner."[62] This is a far different meaning than essential. That the impairment standard does not impose such a requirement is further confirmed by the Act's inclusion of a stricter "necessary" standard for those network elements that are proprietary in nature.[63] As a matter of logic and plain usage, the "impair" standard must be more lenient than the "necessary" standard, which is, in turn, more lenient than the "essential facilities" standard. The legislative history of the 1996 Act confirms that Congress did not intend to adopt an essential facilities standard. Although Congress was aware of the essential facilities doctrine and related antitrust requirements when it was debating early versions of the 1996 Act,[64] Congress chose not to include such requirements in the Act.

IV. OTHER LEGAL ISSUES

A. Service-Specific Requirements

Contrary to SBC's claim, the Commission is not legally required to conduct service-specific impairment analyses.[65] In fact, as WorldCom has previously explained in some detail,[66] the service-specific analysis that SBC advocates is actually prohibited by the Act. Section 251(c)(3) expressly requires incumbent LECs to provide requesting carriers nondiscriminatory access to UNEs "for the provision of *a telecommunications service*."[67] Neither this section nor any other limits the kind of telecommunications service for which unbundled access must be provided, or authorizes the Commission to impose such limits. Indeed, as long as a competitive carrier uses the UNE to provide a telecommunications service, the FCC cannot further limit the uses to which the carrier puts that element.[68]

Nevertheless, in its reply comments, SBC insists that the D.C. Circuit has "squarely rejected" the claim that section 251(c)(3) requires network elements to be made available to competitive carriers for use in the provision of any telecommunications service that uses the element as an input.[69] According to SBC, the court went so far as to

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62 *See Humana Inc. v. Forsyth*, 525 U.S. 299, 309-10 (1999) (*quoting* Black's Law Dictionary at 752 (6th ed. 1990)).

63 *See* 47 U.S.C. § 251(d)(2)(A).

64 *See* 140 Cong. Rec. H 5243 (daily ed. June 28, 1994) (statement of Rep. Crapo); S. 652, 104th Cong. § 101 (1995), as passed by the Senate, reprinted in 141 Cong. Rec. H 9954, H 9956 (daily ed. Oct. 12, 1995) (draft of section 251(a)(1)).

65 *See* SBC Reply Comments at 61-67.

66 *See* WorldCom Comments at 52-61; WorldCom Reply Comments at 30-36, 74.

67 47 U.S.C. § 251(c)(3) (emphasis added).

68 *See* WorldCom Comments at 53-54.

69 SBC Reply Comments at 65.

characterize this interpretation of section 251(c)(3) as "quite unreasonable."[70] Yet a reading of the *USTA* decision reveals nothing of the sort. The section of the statute that the court found to have been interpreted in a "quite unreasonable" manner was section 251(d)(2)(B) – not section 251(c)(3).[71] The issue that prompted the court's admonition was the relevance of intermodal competition to the impairment analysis for the high frequency portion of the loop, not service restrictions. The *USTA* court never addressed – "squarely" or otherwise – the distinct and more general legal issue of whether the Commission may limit a competitor's use of UNEs to certain kinds of services.

In a recent *ex parte* filing, SBC has taken a different tack, this time claiming that "[t]he FCC cannot, consistent with *USTA v. FCC*, allow UNEs to be used in competitive markets,"[72] such as special access, or to provide long distance services. In making this argument, SBC muddles the analysis by confusing upstream and downstream markets, as well as fundamentally mischaracterizing the *USTA* decision.

In a series of decisions regarding the introduction of competition into formerly monopoly markets, the Commission has consistently recognized that an incumbent LEC may have market power in an upstream market (*e.g.,* exchange and exchange access) but be found non-dominant in the downstream market (*e.g.*, interexchange services), *provided that* sufficient safeguards exist to prevent the incumbent LEC from engaging in anti-competitive behavior in the downstream market.[73] The availability of UNEs remains one of the key safeguards against incumbent LECs seeking to use their market power over local transmission facilities to gain an anti-competitive advantage in downstream markets.[74]

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70 *Id.* at 65 n.206 (*quoting USTA*, 290 F.3d at 429).

71 *USTA*, 290 F.3d at 429 ("The Commission's inference from § 251(d)(2)(B)'s allusion to the services the requester 'seeks to offer' strikes us as quite unreasonable.").

72 *Ex parte* presentation attached to Letter to Marlene Dortch, FCC, from Brian J. Benison, SBC, at 18 (Sept. 30, 2002).

73 *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Exchange Area,* Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd 15756, ¶¶ 6-7, 91 (1997). Commission precedent in this area is summarized in the Commission's recent notice regarding the non-dominant treatment of incumbent LEC broadband services. *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services,* Notice of Proposed Rulemaking, 16 FCC Rcd 22745, ¶¶ 8-16 (2001).

74 SBC's claims with respect to the state of competition for special access are simply wrong. As the record in the *Special Access Provisioning* proceeding demonstrates, competitors remain heavily dependent on incumbent LECs for last mile facilities. *See, e.g.,* Reply Comments of WorldCom, CC Docket No. 01-321, at 3-6 (Feb. 12, 2002); Comments of WorldCom, CC Docket No. 01-321, at 9-12 (Jan. 22, 2002).

The *USTA* court did, of course, state that the Commission must consider the "competitive context" of a network element in determining whether competitors are impaired without unbundled access to that element under section 251(d)(2).[75] Contrary to SBC's claim, however, the *USTA* court never stated that once a network element has been determined to be subject to unbundling under section 251(d)(2), that network element may be subject to service-specific restrictions based on the alleged "competitiveness" of certain downstream markets. Under *USTA*, the appropriate (and only) time to consider the "competitive context" is during the impairment analysis. After the Commission has completed that analysis and determined that a particular network element is subject to unbundling for a particular geographic area, competitors are free – in accord with the Act and with *USTA* – to use that UNE to provide any "telecommunications service" they desire.

Accordingly, the Commission should make clear that, once it has required an incumbent LEC to provide unbundled access to a particular element, the incumbent LEC is required to make that element available to competitive carriers for use in the provision of *any* telecommunications service that uses the element as an input.[76]

B. Sunset Provisions Are Inconsistent with the Act

The BOC proposals for an automatic sunset provision for UNEs are squarely foreclosed by the Act.[77] The impairment mandate of section 251(d)(2)(B) imposes no temporal limit on the duration of a requesting carrier's impairment. Rather, it requires incumbents to provide unbundled access to network elements whenever impairment is found to exist. A sunset provision that tolled the requirement to provide unbundled access to a particular element prior to the cessation of impairment with respect to that element would therefore violate the Act. Indeed, despite Verizon's claim that unbundling was intended to be merely a "transitional mechanism,"[78] some elements (such as low-capacity loops) might need to be available for an indefinite period of time. Under the Act, the only relevant question is whether competitive LECs are impaired without access to a particular UNE. The length of time that an element has been offered on an unbundled basis is not a relevant factor.

V. CONCLUSION

For the foregoing reasons, WorldCom urges the Commission to reject the incumbent LECs' attempts to weaken the unbundling rules. Instead, the Commission should require the incumbent LECs to provide requesting carriers with nondiscriminatory access to the UNEs and UNE combinations discussed in WorldCom's Comments and Reply Comments, at TELRIC-based rates, as required by the Act.

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75 *USTA*, 290 F.3d at 429.

76 *See* WorldCom Comments at 54.

77 *See* BellSouth Reply Comments at 80, n.212; Verizon Comments at 70.

78 Verizon Reply Comments at 45.